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SENSITIVE
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TAGS: ECON PGOV EAID ETRD CB
SUBJECT: CAMBODIAN ECONOMY SHAKEN BY THE GLOBAL ECONOMIC SLOWDOWN

REFS: A) PHNOM PENH 277
B) PHNOM PENH 276

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: The global economic crisis continues to take a heavy toll on Cambodia's once vibrant economy. Cambodia's narrowly-based economic growth, reliant almost exclusively upon garment exports, tourism, and construction, has been brought to a standstill by the sharp fall off in external demand and foreign investment flows. Economic growth is predicted to contract by as much as negative 2.75% this year and a growing budget deficit could threaten macroeconomic stability. End Summary.

Growth Forecasts Even Gloomier

¶2. (U) The global economic crisis has had a more profound effect on Cambodia's economy than previously anticipated. Both the International Monetary Fund (IMF) and Asia Development Bank (ADB) recently revised growth forecasts downwards. The ADB, which previously predicted a positive growth rate of 2.5%, now predicts a negative 1.5% contraction. The IMF is predicting growth to slow to negative 2.75%, from the negative 0.5% contraction predicted earlier this year.

¶3. (U) Foreign direct investment (FDI) flows have slowed as a result of the global downturn as well. The IMF predicts FDI to decline nearly 50% in 2009. The drop in FDI has had a significant impact on Cambodia's construction sector, given the sector's heavy dependence on foreign, primarily South Korean, investors. Several large-scale construction projects have stalled or been scaled down, and fewer new projects have been approved.

¶4. (U) During a meeting with the Ambassador September 21, David Cowen, the IMF's Deputy Division Chief for the Asia and Pacific Department, expressed concerns about the stability of the banking sector due to the potential for an increase in non-performing loans, given the extent of lending which is linked to the now stagnant real estate sector. Cowen also expressed concern about Cambodia's macroeconomic stability, citing in particular a growing budget deficit which is projected to rise to 6.75% of GDP in 2009 (up from 2.75% a year earlier). The expanding deficit is due in part to large salary increases for civil servants and the military, an increase from 1% of GDP to 5% of GDP in 2009. Domestic financing of the growing deficit could erode domestic deposits and foreign reserves, threatening macroeconomic stability. The RGC has defended these wage increases and Cheam Yeap, Chairman of the National Assembly's Finance Committee, was recently quoted in local press affirming the government's commitment to the wage increases, arguing that they are necessary to raise living standards.

Garment Exports Plummet

¶5. (U) Garment exports, a key sector in Cambodia's economy, have fallen precipitously. According to figures from the Ministry of

Commerce, in the first six months of the year, total garment exports declined by 24.2% year-on-year with garment exports to the U.S. falling 31.5%. A total of 49 factories have closed their doors in the first half of the year, while 20 new factories opened during this same time, according to the Ministry of Commerce.

¶6. (SBU) While U.S. demand for garments has fallen, the decline in imports from Cambodia is disproportionately large compared to the falloff in total U.S. garment imports, indicating that Cambodia's garment industry is losing market share to other regional competitors. The government has responded by extending tax incentives to manufactures, but has thus far failed to address the real challenges to the competitiveness of Cambodia's garment industry (Ref A).

¶7. (SBU) Buyers are making decisions to source elsewhere due to problems which plague Cambodia's industry, such as poor infrastructure, low productivity, strained industrial relations, and corruption. For example, a deal that reportedly would have been worth more than USD100 million annually in orders from Japan, went to Bangladesh last year instead. President of the Garment Manufacturer's Association in Cambodia Van Sou Ieng told Econoff that "informal fees" encountered during the customs clearance process for a sample shipment factored heavily in the Japanese buyer's decision to source elsewhere.

Tourist Arrivals Down But Not Out

¶8. (U) Accounting for 16 percent of Cambodia's GDP in 2008, and employing roughly 300,000 workers, Cambodia's tourism industry help fuel the past decade of rapid economic growth. However, the global economic crisis, coupled with the political turmoil in Thailand, has

taken a toll on the sector's once robust growth. Growth slowed to 5.5 percent in 2008, compared to the nearly 20 percent growth in ¶2007. According to the Ministry of Tourism's statistics, tourist arrivals to Cambodia declined by only 1.1 percent in the first half of the year, compared to the same period in 2008. However, this figure does not accurately reflect the significant impact that the change in the types of tourists visiting Cambodia is having on the sector.

¶9. (SBU) The IMF estimates that tourists arriving by air have fallen by double digits so far this year. Ho Vandy, President of the Cambodia Association for Travel Agents (CATA) and Co-Chairman of Government-Private Sector Working Group on Tourism, told Econoff that long-haul tourists have decreased, replaced by visitors who spend less time and less money during their visit.
According to the Ministry of Tourism, South Korean visitors, who had been the largest group visiting Cambodia in 2008, fell an estimated 33% in the first six months, while tourist arrivals from Vietnam have increased by approximately 40% and arrivals from Laos have risen 141% during this same period. (NOTE: The increase in Vietnamese visiting Cambodia may in part be attributable to the December 2008 implementation of visa waivers between the two countries. END NOTE.)

¶10. (SBU) The country's foremost tourist destination Siem Reap has been hardest hit. According to the Minister of Tourism, the majority of Vietnamese tourists visit Phnom Penh, rather than Siem Reap. Many of these tourists visit Cambodia on inexpensive package tours, Ho Vandy explained. Revenues generated from the increase in Vietnamese visitors fall short of offsetting the loss of South Korean or other tourists who in general spent more time and money per visit.

¶11. (SBU) Hotel occupancy rates in Siem Reap declined 30 to 40 percent in the first six months of this year. Ho Vandy reports that approximately 7 to 8 percent of Siem Reap's 120 hotels have shut their doors temporarily during the low season from March to September, another 30 to 40 percent have suffered from profit losses, and some have downsized employees by 50%, contributing to rising unemployment in the area. He said that roughly 2,000 workers in this sector have already lost their jobs or have been temporarily suspended until after the low season, waiting for the sector to recover.

¶12. (U) In what may prove a positive sign, tourist arrivals increased in July, rising by an estimated 10 percent to offset declines earlier in the year, resulting in an increase of 0.63 percent in the number of tourist arrivals to Cambodia in the first 7 months. Ho Vandy also told Econoff that hotel bookings have recently picked up for later in the year, with reservations from Japan, Europe, and the U.S. on the rise.

Silver Lining?

¶13. (SBU) As other key sectors of the economy are declining, the one positive note is growth in the agriculture sector, which the IMF predicts to expand by 5% in 2009. Cambodia's longer-term prospects are also hopeful. While Cambodia's economy is expected to contract from 2.75% to 1% in 2009, both the IMF and ADB predict growth to resume in 2010. Contingent on a global economic recovery, and assuming that tourism-source and garment-source countries' economies recover quickly, Cambodia's economy is predicted to expend by 3.5% (ADB) or as much as 4.25% (IMF) in 2010.

Comment

¶14. (SBU) The sharp decline in economic activity could have significant consequences for the sustainably of the government's budget, as revenues decline while increased spending is needed in priority sectors such as health, education, and infrastructure. Sound macroeconomic and financial policies are needed to mitigate the impact of the slowdown, but the government has thus far failed to launch a comprehensive response to the crisis.

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